(21)

TRANSCRIPT OF RECORD.

FILED
AUG 18 1942
CHARLES ELMORE CROPLEY
CLERK

UNITED STATES

CIRCUIT COURT OF APPEALS

FIFTH CIRCUIT.

No. 9897

LAKESIDE IRRIGATION CO., INC.,

Petitioner,

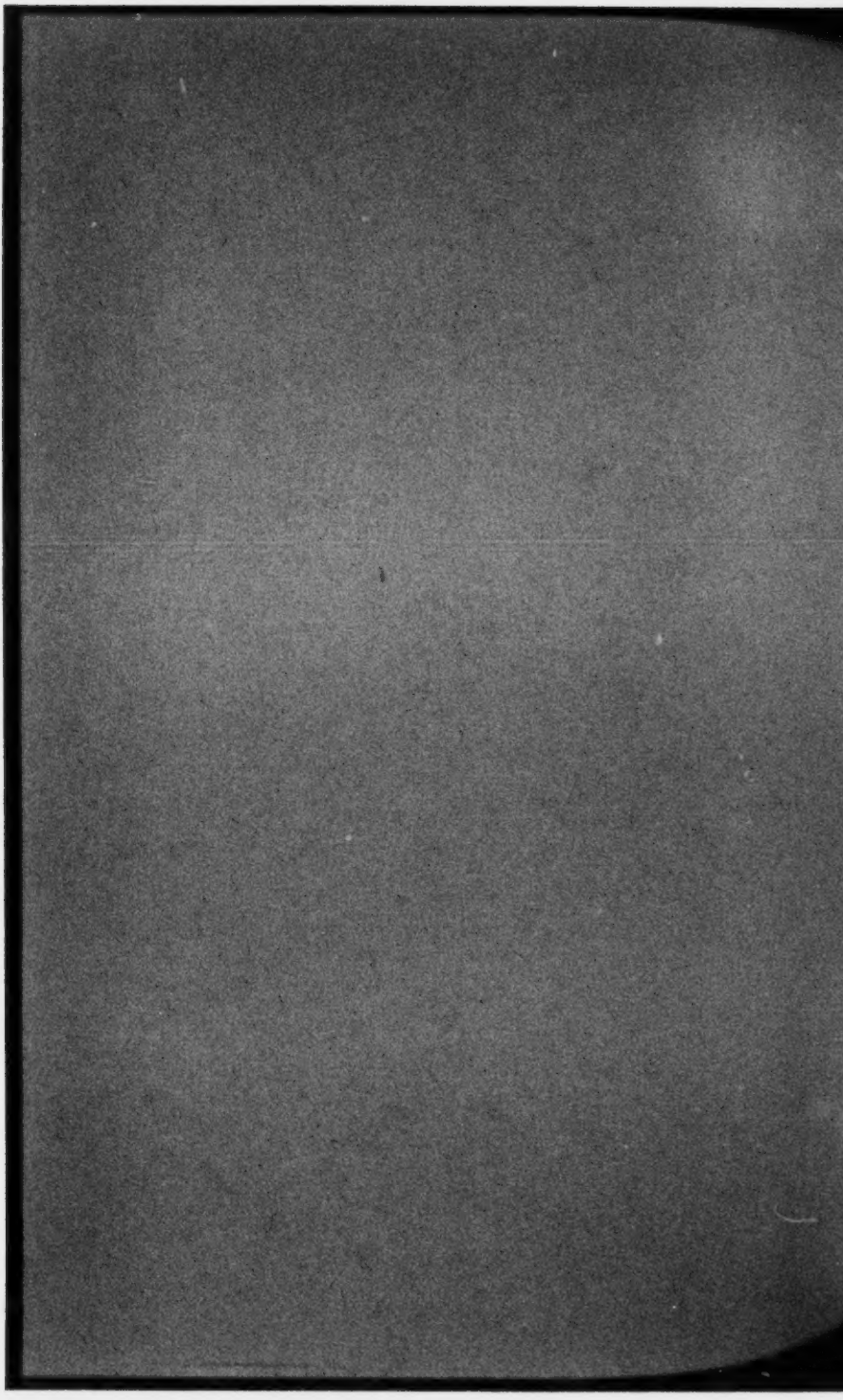
versus

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petition for Review of Decision of the United States Board of Tax Appeals, (District of Texas).

(ORIGINAL RECORD RECEIVED APRIL 5, 1941.)
U. S. CIRCUIT COURT OF APPEALS
FILED
MAY 8 1941
Quitty E. Robb
Clerk



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TRANSCRIPT OF RECORD.

UNITED STATES CIRCUIT COURT OF APPEALS,
FIFTH CIRCUIT.

LAKESIDE IRRIGATION COMPANY, INC.,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition to Review the Decision of the United States Board of Tax Appeals.

DOCKET ENTRIES.

Lakeside Irrigation Company, Inc., Petitioner,
vs. Docket No. 96745.
Commissioner of Internal Revenue, Respondent.

Appearances:
For Petitioner: Charles F. Byers, Esq.,
Camden R. McAtee, Esq.
For Respondent: W. H. Payne, Esq.,
E. M. Woolf, Esq.,
R. C. Whitley, Esq.

1939.
Jan. 13—Petition received and filed. Taxpayer notified. (Fee paid.)
Jan. 13—Copy of petition served on General Counsel.
Feb. 28—Answer filed by General Counsel.
Feb. 28—Request for Circuit Hearing in Houston, Texas, filed by General Counsel.

1939.

Mar. 6—Notice issued placing proceeding on Houston Calendar. Answer and request served.

Dec. 7—Hearing set Jan. 15, 1940, in Houston, Texas.

1940.

Jan. 15—Hearing had before Mr. Black. Submitted. Stipulation of facts filed. Briefs due Feb. 29, 1940—replies due March 15, 1940.

Feb. 9—Transcript of hearing Jan. 15, 1940 filed.

Feb. 27—Brief filed by taxpayer.

Feb. 29—Brief filed by General Counsel.

Mar. 1—Copy of brief served on General Counsel.

Apr. 23—Findings of fact and opinion rendered—Eugene Black, Division 15. Decision will be entered under Rule 50.

May 10—Computation of deficiency filed by General Counsel.

May 15—Hearing set June 19, 1940, on settlement.

May 16—Motion that the Board grant 30 days in addition to the time allowed by the rules for the filing of a petition for rehearing, filed by taxpayer.

May 24—Notice to disregard notice of hearing under Rule 50 for June 19, 1940.

June 22—Notice of appearance of Camden R. McAtee as counsel for taxpayer, filed.

June 22—Motion for leave to file amended petition filed by taxpayer—amended petition lodged.

June 22—Motion for rehearing and to set aside and vacate opinion, filed by taxpayer.

July 5—Motion for leave to amend petition denied.

July 3—Order denying motion for rehearing (memorandum attached) entered.

July 5—Hearing set July 24, 1940, on settlement.

July 24—Hearing had before Mr. Smith on settlement under Rule 50. Respondent's recomputation not contested—referred to Mr. Black, for decision.

1940.

July 25—Decision entered—Black, Division 15.

Sept. 20—Motion to rehear motion for rehearing; for leave to file amended petition heretofore overruled *exparte;* and to set aside decision, filed by taxpayer.

Sept. 20—Order setting aside decision entered July 25, 1940, and that petitioner be reheard upon its motion to set aside or modify the opinion herein, and file its amended petition, and that such rehearing on petitioner's said motions be set for Oct. 16, 1940, Washington, D. C., entered—Black, Division 15.

Oct. 11—Motion for a continuance of 2 weeks from Oct. 16, 1940, filed by taxpayer.

Oct. 12—Motion for a continuance granted to 10/30/40.

Oct. 30—Hearing had before Mr. Black on motion of petitioner to file an amended petition, and for a rehearing. C. A. V. Memo on behalf of petitioner filed.

Oct. 31—Computation of deficiency filed by taxpayer.

Nov. 19—Transcript of hearing 10/30/40 filed.

1941.

Jan. 10—Order denying motion for rehearing (memorandum accompanying) entered.

Jan. 10—Decision entered—Black, Division 15.

Feb. 13—Petition for review by U. S. Circuit Court of Appeals, Fifth Circuit, with assignments of error filed by taxpayer.

Feb. 13—Proof of service filed by taxpayer.

Mar. 7—Agreed praecipe filed.

3 PETITION.

Received Jan. 13, 1939.

Filed Jan. 13, 1939.

United States Board of Tax Appeals.

Lakeside Irrigation Company, Inc., Petitioner,
vs. Docket No. 96745.
Commissioner of Internal Revenue, Respondent.

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency, dated December 3, 1938, and as a basis for its proceedings, alleges as follows:

First. Petitioner is a Corporation chartered and operating under the laws of the State of Texas, with its principle place of business in Eagle Lake, Colorado County, Texas. Its postoffice address is Eagle Lake, Texas.

Second. The notice of deficiency, a copy of which it attached, was directed or mailed to Petitioner at Eagle Lake, Texas, on or about December 3, 1938.

Third. The amount of the deficiency determined by the Commissioner of Internal Revenue is Three Thousand, Five Hundred and Fifty-six and 22/100 ($3,556.22) Dollars and is income taxes for the year of 1936. The determination of tax set forth in the said notice of deficiency is based on the following errors:

(1) The Commissioner of Internal Revenue erred in his adjustment (a) wherein he sets up an additional in-

come arising from Capital Gains of $11,175.50. From this source and by this error overstates Petitioner's income by Eleven Thousand One Hundred Seventy-five and 50/100 ($11,175.50) Dollars.

The facts on which Petitioner relies as the basis of this proceeding are as follows:

(a) Taxpayer, prior to April 28, 1936, was the owner of some stock. At the same time, there was a debt owing by the Petitioner for canal rentals amounting to One Hundred Thousand, Five Hundred and Twelve and 22/100 ($100,512.22) Dollars. This debt was due to Mrs. Louise Wintermann, E. L. Wintermann, and O. J. Wintermann. These three were the owners of 736 shares of 1,000 outstanding shares of Capital Stock of Petitioner.

(b) The Directors of the Petitioner, desirous of paying this rental obligation, decided to sell its stocks on the open market and apply the proceeds to the payment of its matured and past due debts.

(c) O. J. Wintermann, acting for Petitioner, then wrote Louise Wintermann and advised her of the proposed sale of the stock on the open market as a part-payment of the debt. Louise Wintermann then advised O. J. Wintermann that, if agreeable to him, she would buy these stocks at actual quoted market price. Whereupon, Petitioner ascertained the market value, and in one sale and in one transaction, sold four different kinds of stock acquired at four different times and received for same Three Hundred Forty-nine and 50/100 ($349.50) Dollars more than all of the stock cost. On its income return, Petitioner reported the profit made on the sale of stock of Three Hundred Forty-nine and 50/100 ($349.50) Dollars and paid all its income tax due thereon.

(d) Petitioner further says that it has never claimed or eliminated any losses from stocks sold whatever on its income return of $11,175.50 or of any other amount. That it sold all its stock in one sale, made a profit on one sale, and though it bought the stocks at four different times, it did not have a profit or loss on its purchases but only on the one sale. At which time, it had one profit; not four profits or losses.

(e) Petitioner insists that its books are accurately and correctly kept and correctly reflects its true financial history. Petitioner further insists that in the present case the books and the intention of the Directors correctly reflects one offer to sell, one acceptance of sale, one ascertainment of market value, one transfer, and one receipt of sales price.

(2) The proposed increase in income due to the disallowance of the accrual of taxes by the Commissioner of Internal Revenue is agreed to by the Petitioner; hence this point is not in dispute.

(3) The Petitioner prays for relief from the deficiency asserted by the Respondent on each of the following particulars:

(a) That the taxable income of the Petitioner be redetermined under the law and the facts for the taxable year of 1936.

(b) That this Appeal be docketed on the field calendar for hearing in or near Houston, Texas, at some future setting of the Board.

Wherefore, Petitioner prays that this Board may hear and determine the amount of the deficiency alleged by the

Respondent for the taxable year of 1936, and for all proper relief.

CHARLES F. BYERS,
(Charles F. Byers),
Attorney-at-Law.

718 Electra Building,
Houston, Texas.

State of Texas,
County of Colorado.

O. J. Wintermann and G. L. Butler, President and Secretary of Lakeside Irrigation Company, respectively, on their oath and each for himself say they have read the foregoing petition and are familiar with the statements therein contained, and that the facts therein stated to be true are known to them to be true.

O. J. WINTERMANN,
(O. J. Wintermann),
President.

G. L. BUTLER,
(G. L. Butler),
Secretary.

(Seal)

Subscribed and sworn to before me this 20th day of Dec., 1938.

W. E. LINHART,
Notary Public, Colorado
County, Texas.

(Seal)

Treasury Department.
Internal Revenue Service,
Dallas, Texas.

Office of
Internal Revenue Agent in Charge,
Dallas Division.

In reply refer to IRA:90D.

Lakeside Irrigation Company,
Eagle Lake, Texas.

Sir:

You are advised that the determination of your income tax liability for the taxable year(s) enled December 31, 1936, disclosed a deficiency of $3,556.22 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 422 Federal Building, Dallas, Texas. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY. T. HELVERING,
Commissioner,
By (Signed) B. W. WILDE.

Enclosures:
Statement.
Form of Waiver.
Des:JW.

7 STATEMENT.

Dallas.
IRA:90D.

Lakeside Irrigation Company,
Eagle Lake, Texas.

Tax Liability for the Taxable Year Ended
December 31, 1936.

	Liability	Assessed	Deficiency
Income Tax	5,488.52	1,932.30	3,556.22

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated August 11, 1938; to your protest dated October 6, 1938; and to the statements made at the conference held on November 7, 1938.

A copy of this letter and statement has been mailed to your representative, Mr. Jno. M. Moore, Post Office Box 1032, Austin, Texas, in accordance with authority contained in a power of attorney executed by you and on file in this office.

Adjustments to Net Income.

Net income as disclosed by return		$12,649.95
Unallowable deductions and additional income:		
(a) Capital gains	11,175.50	
(b) Accrued taxes 1935	2,481.12	13,656.62
Total		26,306.57
Additional deductions:		
(c) Accrued taxes 1936		508.97
Net income adjusted		25,797.60

Explanation of Adjustments.

(a) Capital gain reported in the amount of $349.50, increased to $11,525.00. The increase of $11,175.50 is due to elimination of unallowable losses applied by you to reduce gains realized from sales of capital assets.

Evidence presented discloses that in the year 1936 you transferred four blocks of investment stocks at market value and certain bonds at cost to Mrs. Louise Wintermann, a stockholder owning directly 332 shares and indirectly 664 shares, or a total of 996 shares out of 1,000 shares of your outstanding capital stock, to apply as payment on your indebtedness which arose through accrual of annual canal rentals. On two of the stocks transferred the market values were in excess of cost, resulting in a profit to you from the sales or exchanges of $11,525.00. The market value of the other stock transferred were less than their costs, resulting in a loss to you of $11,175.50, which amount you applied as a reduction against the gain of $11,525.00 in arriving at the net capital gain of $349.50 reported by you.

This office holds that the disposition of each block of stocks and bonds represents a separate sale or exchange; that the losses arising from the separate sales or exchanges are governed by the provisions of section 24 (a) (6) of the Revenue Act of 1936 and, therefore, constitute unallowable deductions, and, as such, are not to be applied to reduce the gains from the sales or exchanges of other assets.

Section 24 (a) (6) of the Revenue Act of 1936 is clear in the statement that in computing net income no deduction shall *in any case* be allowed in respect of loss from sales or exchanges of property, directly or indirectly, between an individual and a corporation in which such

individual owns, directly or indirectly more than 50 per centum in value of the outstanding stock, except in the case of distributions in liquidation.

(b) Inasmuch as your books and records are on the accrual basis and your returns are filed on such basis, the following amounts, which represent proper accruals for the year 1935, are not allowable deductions for the year 1936:

Taxes	Accrual Date	Amount
State, County and School	1-1-1935	2,131.12
Capital stock tax year ended 6-30-36	7-1-1935	350.00
Total		$2,481.12

(c) The following amounts represent taxes accrued in 1936, not claimed as a deduction on return:

Texas Unemployment taxes	$149.37
Federal Unemployment taxes	16.60
Capital stock tax for year ended 6-30-37.....	343.00
Total	$508.97

Computation of Income Tax.

Normal Tax:	
Taxable net income	$25,797.60
Less: Dividends received credit (85% of $187.50)	159.37
Normal tax net income	25,638.23
8% of $2,000.00	160.00
11% of $13,000.00 (over $2,000.00 to $15,000.00).	1,430.00
13% of $10,638.23 (over $15,000.00 to $25,638.23)	1,382.97
Total normal tax	$2,972.97

Surtax on Undisputed Profits:		
Taxable net income	25,797.60	
Less: Normal tax	2,972.97	
(a) Adjusted net income	22,824.63	
Less: Dividends paid credit	6,000.00	
(b) Undistributed net income	16,824.63	
Specific credit ($5,000.00 less 10% of (a)	2,717.54	
Remainder subject to surtax	$14,107.09	
7% of $2,282.46 10% of (a)	159.77	
12% of $2,282.46 (over 10%, not over 20% of (a)	273.90	
17% of $4,564.92 (over 20%, not over 40% of (a)	776.04	
22% of $4,564.93 (over 40%, not over 60% of (a)	1,004.28	
27% of $412.32 (over 60% of (a)	111.33	
Amount of Tax	$2,325.32	
Plus 7% of $2,717.54 (Specific credit)	190.23	
Total surtax		2,515.55
Correct income tax liability, Normal tax and Surtax		5,488.52
Income tax assessed, account #402066		1,932.30
Deficiency of income tax		$3,556.22

10 ANSWER.

Received Feb. 28, 1939.

Filed Feb. 28, 1939.

(Title Omitted.)

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

First. Admits the allegations contained in paragraph First of the petition.

Second. Admits the allegations contained in paragraph Second of the petition.

Third. Admits that the taxes in controversy are income taxes for the year 1936 and that the deficiency asserted is $3,556.22.

Third (1). Denies that respondent's determination is based on errors as alleged in paragraph Third (1) of the petition.

Third (1) (a) to (e), inclusive. Denies the material allegations of fact set forth in subparagraphs (1) (a) to (e), inclusive, of paragraph Third of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination of deficiency be approved.

(Signed) J. P. WENCHEL, JHY.
(J. P. Wenchel),
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
JAMES H. YEATMAN,
Special Attorney,
Bureau of Internal Revenue.

JHY:jr. 2-21-39.

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12 STIPULATIONS.

Filed at Hearing Jan. 15, 1940.

(Title Omitted.)

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel, that the following facts are true and may be so found by the Board. It is further understood that this proceeding is to be submitted on the following stipulation of facts without the introduction of any other or further evidence.

1. Lakeside Irrigation Company, Inc., the petitioner herein is a Texas corporation, organized under the laws of the State of Texas, by charter dated January 1, 1926, with its principal office and place of business at Eagle Lake, Colorado County, Texas.

2. That during the year of 1936 said corporation had no preferred stock outstanding.

The common stock of this corporation, during the year of 1936 was owned and held by the following individuals:

Name	Shares Owned	Relationship
Mrs. Louise Wintermann	332	Mother of O. J. and E. L. Wintermann.
E. L. Wintermann	332	Brother of O. J. Wintermann and son of Louise Wintermann.
O. J. Wintermann.....	72	Brother of E. L. Wintermann and son of Louise Wintermann.
David Wintermann	130	Son of O. J. Wintermann.
Gloria Wintermann	130	Daughter of O. J. Wintermann.
Directors.....	4	(Qualifying shares.)

Total outstanding 1000 shares of common stock.

The residence and post address of Mrs. Louise Wintermann and of E. L. Wintermann was and is St. Louis, Missouri, and the residence and post office address of the remaining stockholders was and is Eagle Lake, Texas.

3. On or about April 16, 1936, the petitioner, Lakeside Irrigation Company, Inc., was indebted to Mrs. Louise Wintermann, individually, in a substantial amount and in excess of $30,000.00. Such indebtedness had been incurred by said corporation for rental of canals, used by it in carrying on and operating its business, and was long past due.

4. Late in 1935 and early in 1936 various plans were considered for retiring the indebtedness to Mrs. Louise Wintermann. As the result of an agreement reached be-

tween the directors and the stockholders residing at Eagle Lake, Texas; on April 16, 1936, O. J. Wintermann, President of Lakeside Irrigation Company, Inc., wrote to Mrs. Louise Wintermann and E. L. Wintermann, at St. Louis, as follows:

"At the annual meeting held last February it was voted to increase our capital stock which I understood was according to you, and in doing so it was my idea to issue stock for part of the unpaid balance and pay as much as we can of the balance due Louise Wintermann in cash. Mr. Whalen suggested that we might get rid of our investment stocks and he stated that he could see no reason for having them in our business which, of course, is not altogether true, as we may need them for collateral purposes. At all events I have concluded to pay the Louise Wintermann obligation in capital stock of the Lakeside Irrigation Company, Inc., and the balance in cash out of the sale of the various stocks we own, namely,

Reed Roller Bit
Dr. Pepper
Columbia Gas and Electric
North American Aviation

which at today's prices would probably yield a net sum of around $25,000.00 or $26,000.00, and this amount to be credited to Louise Wintermann account. Then of course I will also take credit for one-third of the distribution which is to come to me and I will do this by applying it against my water rent account. I am suggesting this procedure and if this does not meet with your approval I will be glad to have you advise me.

"As it now stands, we own 600 shares of Reed Roller Bit which is a Houston Company whose stock is listed on the New York Curb. The market value of this stock I would say, today, would be about $13,000.00.

"Also 250 shares Dr. Pepper on which the market value today is approximately $10,000.00.

"100 shares Columbia Gas and Electric Co., the market value of which is about $1,600.00.

"100 shares North American Aviation, the market value of which is approximately $700.00.

"Now we can either sell this stock outright or we can turn it over to you to apply on the obligation due from the Irrigation Company, and you will get a credit of approximately $25,000.00. Of course, if we turn it over to you, if the Company ever got in dire need, you can let us use it as collateral security in case it is not to be sold."

The stocks thus offered constituted and included all of the stocks of other corporations owned by the petitioner.

On April 19, 1936, Mrs. Louise Wintermann accepted the offer to sell and advised that she preferred to buy the stock at market price. This acceptance was by long-distance telephone direct to O. J. Wintermann.

5. On April 20, 1936, a called meeting of directors was held and page 79 of the Minute Book shows as follows:

"Minutes of the Directors' Meeting Apr. 20, 1936, (at 2 o'clock P. M., at the office of the Company).

"There were present at the meeting the following directors: O. J. Wintermann, David Wintermann and G. L. Butler.

"This meeting was called for the purpose of hearing the report of the president on the matter of increasing the capital stock in conformance with the resolution of the Board of Directors at the meeting held on February 25, 1936. The president stated that after a conference with

the company's attorney it was concluded to take no action towards increasing the capital stock of the company, as it was not necessary to pass the company's surplus into capital because of any proposed legislation and that the company's present surplus should not, in the opinion of the attorney, be affected by any such proposed legislation, and no benefit could be derived from such action; therefore the following resolution was introduced and passed:

" 'Be it Resolved that the directors take no action towards increasing the capital stock of the company until the next stockholders' meeting.'

"At the Directors' Meeting on February 25, 1936, it was recommended that the investment stocks held by the company be sold; the president stated that he had been advised by Louise Watermann that she would take the stocks held by the company at their market value to be applied on the company's indebtedness to her; whereupon the following resolution was offered:

" 'Resolved that the president be directed to ascertain immediately the market value of all the investment stocks held by the company and, when this is done, that he deliver these stocks to Louise Wintermann as soon as he has satisfied himself as to their market value, it being the intention of the Board that all these stocks be delivered at one time and as of the market value on a certain date, and that the company credit the market value of these stocks as of the value date in a lump sum to the account of Louise Wintermann.'

"A motion for the resolution was made, duly seconded and unanimously passed.

"There being no further business, the meeting was adjourned.

"Attest:
"G. L. BUTLER.

"Approved:

"O. J. WINTERMANN,
"President."

6. Immediately following the directors meeting on April 20, 1936, steps were taken by the corporation to ascertain the market values of the respective stocks being sold to Mrs. Wintermann. On April 28, 1936, the inquiries were completed, the stocks were delivered to Mrs. Wintermann, and the indebtedness of the corporation to her was reduced by the sum of $26,737.50, representing the aggregate market value of the four stocks on the date of the sale. The following tabulation shows the date of acquisition and the cost and selling price of each of the four stocks sold, as well as the resulting gain or loss with respect to the separate stocks and the resulting net gain to petitioner on the sale of the four stocks treated as a unit.

Stock Acquired	Cost	Selling Price	Gain	Loss
600 shares, Reed Roller Bit, 10-10-29 and 11-15-30	$7,100.00	$13,500.00	$6,400.00	
250 shares, Dr. Pepper, 10-10-29	5,625.00	10,750.00	5,125.00	
100 shares,				

Columbia Gas, 9-18-29	11,750.50	1,725.00		$10,025.50
100 shares, N. Amer. Aviation, 3-21-29	1,912.50	762.50		1,150.00
Totals	$26,388.00	$26,737.50	$11,525.00	$11,175.50

Aggregate selling price	$26,737.50
Less: Aggregate cost of stocks	$26,388.00
Net Gain	$ 349.50
Aggregate gain on Reed Roller Bit and Dr. Pepper stocks	$11,525.00
Less: Aggregate loss on Columbia Gas and North American Aviation stocks	11,175.50
Net Gain	$ 349.50

7. The transaction was treated by petitioner as one wherein only the resultant net gain from the sale of all the four stocks is to be taken into account. Consequently, in recording the transaction on its books of account the petitioner made the following journal entry:

April 28, 1936	Mrs. Louise Wintermann	Dr. 26,737.50	
	Securities	Cr.	26,388.00
	Loss and Gain	Cr.	349.50

In its income tax return filed for the calendar year 1936 petitioner reported disposition of the stocks as follows:

On page 3 of the Return:

Schedule B—Capital Gains and Losses (From Sales or Exchanges Only).

(See Instruction 11.)

1. Description of property	2. Date acquired	3. Date sold	4. Gross sales price (contract price)	5. Cost	9. Gain or Loss
Reed Roller Bit	10-10-29	4-28-36			
Reed Roller Bit	11-15-30	4-28-36	$13,500.00	$7,100.00	$6,400.00
Dr. Pepper	10-10-29	4-28-36	10,750.00	5,625.00	5,125.00
Columbia Gas & E.	9-18-29	4-28-36	1,725.00	11,750.50	(—10,025.50)
N. Amer. Aviation	3-21-29	4-28-36	762.50	1,912.50	(— 1,150.00)
			26,737.50	26,388.00	

Gain or Loss (enter net amount as Item 11, page 2; if net amount is a loss, enter that amount or $2,000, whichever is less) $349.50

State (1) how property was acquired, *By purchase;* (2) whether at time of sale or exchange purchaser owned more than 50% in value of your outstanding stock, *No.*

Every sale or exchange of stock should be reported in detail, including name and address of corporation, class of stock, number of shares, capital changes affecting basis (stock dividends, other non-taxable dividends, stock rights, etc.)

Cost of property must be entered in column 5 if a loss is claimed in Column 9.

There is attached hereto as Exhibit "A", Instructions issued for use of taxpayer in preparation of income tax return made pursuant to Revenue Act of 1936.

8. The Commissioner, in his determination of deficiency as set forth in the deficiency notice, included in petitioner's taxable income the capital gains aggregating $11,525.00 on the sale of Reed Roller Bit and Dr. Pepper stocks, but treated the losses on Columbia Gas and North American Aviation stocks, aggregating $11,175.50, as unallowable as deductions from taxable income by reason of the provisions of section 24(a)(6) of the Revenue Act of 1936.

9. It is further agreed that in the event the Board approves the action of the Commissioner as to the issue presented for decision, then the correct deficiency is as set out in the deficiency notice, a true copy of which is attached to the petition. On the other hand, if the Board determines that the method followed by petitioner in computing the taxable income on the sale of the stocks in question is correct, then, due to the fact that the Commissioner made another adjustment in the deficiency notice which is not contested by petition, the resulting deficiency may be computed under Rule 50 of the Board's Rules of Practice.

CHARLES F. BYERS,
(Charles F. Byers),
Counsel for Petitioner.

(Signed) J. P. WENCHEL, JHY.
(J. P. Wenchel),
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

20 United States Board of Tax Appeals.

Lakeside Irrigation Company, Inc., Petitioner,
Commissioner of Internal Revenue, Respondent.

Docket No. 96745. Promulgated April 23, 1940.

Petitioner was the owner of certain shares of stock in several corporations, which it had been holding for investment purposes. It sold these stocks at their then fair market value to one of its stockholders, to be credited on its indebtedness to the stockholder. Two blocks were sold at a profit and two at a loss. The net result was a small profit on the whole transaction, which profit petitioner reported on its income tax return. The sale was a bona fide sale made for business purposes and not to take a tax loss. The stockholder owned directly or indirectly, as defined by section 24 (a) (6), Revenue Act of 1936, more than 50 per cent of petitioner's stock. *Held*, that, because of the limitations of section 24 (a) (6), petitioner can not offset the gains from the sale of two of the blocks of stock by losses from the sale of the other two blocks. Each block of stock must be treated separately and the losses in question can not be deducted because of the provisions of that section.

Charles F. Byers, Esq., for the petitioner.
Wilford H. Payne, Esq., for the respondent.

The Commissioner has determined a deficiency in petitioner's income tax liability for the year of $3,556.22. The deficiency arises because of their following adjustments to net income made by the Commissioner in petitioner's income tax return filed for the year 1936:

Unallowable deductions and additional income:

(a)	Capital gains	$11,175.50
(b)	Accured taxes 1935	2,481.12

The Commissioner made one adjustment in petitioner's favor, which is not contested, and no further statement of it need be made. Petitioner does not contest adjustment (b), shown above, but by an appropriate assignment of error alleges that the Commissioner erred in making adjustment (a).

FINDINGS OF FACT.

The facts have been stipulated and we find the facts as stipulated. We state herein such of the facts as seem pertinent to an understanding of the issue which we have to decide. The Lakeside Irrigation Co., the petitioner herein, is a corporation organized under the laws of the State of Texas, with its principal office and place of business at Eagle Lake, Texas.

On or about April 16, 1936, the petitioner was indebted to Louise Wintermann in a substantial amount in excess of $30,000. This debt had been incurred by petitioner for the rental of canals which were used in the operation of its business, and it was long past due. Various plans were considered late in 1935 and early in 1936 for retiring this indebtedness, one of which was to increase the capital stock of the corporation, which increase had already been considered and approved by the board of directors. However, in a letter dated April 16, 1936, to Louise Wintermann and E. L. Wintermann from O. J. Wintermann, president of the petitioner, O. J. Wintermann offered to sell outright all the investment stocks held by the corporation and turn the proceeds of the sale (approximately $26,000) over to Louise Wintermann in cash as a partial satisfaction of the debt owing to her. O. J. Wintermann also in this same letter made an alternative offer to Louise Wintermann to turn the stocks over to her at their market value. The letter concluded as follows: "Of course, if we turn it over to you, if the Company ever got in dire need, you can let us use it as collateral security in case it is not

to be sold." The alternative offer to sell the stocks in question to her at their market price was accepted on April 19, 1936, by Louise Wintermann.

A called meeting of the board of directors was held on April 20, 1936, with the following directors present: O. J. Wintermann, G. L. Butler, and David Wintermann. At this meeting, the directors by resolution resolved that no action be taken towards increasing the company's capital stock, which had been approved at the director's meeting held on February 25, 1936. The president, O. J. Wintermonn, also advised the directors of the offer and acceptance of the offer to sell the company's stocks to Louise Wintermann. The board of directors by resolution then directed the president to ascertain the market value of these stocks and deliver them to Louise Wintermann. It was the intention of the board of directors to deliver all of these stocks at one time on a certain date, and that Louise Wintermann's account be credited with one lump sum. This resolution was in part as follows:

> * * * that he deliver these stocks to Louise Wintermann as soon as he has satisfied himself as to their market value, it being the intention of the Board that all these stocks be delivered at one time and as of the market value of a certain date, and that the Company credit the market value of these stocks as of the value date in a lump sum to the account of Louise Wintermann.

Immediately following the directors' meeting on April 20, 1936, the market value of the stocks was ascertained and on April 26, 1936, the stocks were delivered to Louise Wintermann in consideration of the cancellation of indebtedness in the amount of $26,737.50, which was the market value of the stocks on the date of the sale.

The following tabulation shows the gain or loss on each stock and the net amount realized by the sale:

Stock Acquired	Cost	Selling Price	Gain	Loss
1. 600 shares Reed Roller Bit, 10-10-29 and 11-15-30	$7,100.00	$13,500.00	$6,400.00	.....
2. 250 shares Dr. Pepper, 10-10-29	5,625.00	10,750.00	5,125.00	.....
3. 100 shares Columbia Gas, 9-18-29	11,750.50	1,725.00	.....	$10,025.50
4. 100 shares N. American Aviation, 3-21-29	1,912.50	762.50	.....	1,150.00
Totals	26,388.00	26,737.50	11,525.00	11,175.50

Aggregate selling price	$26,737.50
Aggregate cost of stocks	26,388.00
Net gain	349.50

This transaction was treated as one by the petitioner on its books and on its income return reporting the net gain as taxable income. In recording the sale on its books, petitioner made the following entry:

April 26, 1936	Mrs. Louise Wintermann	Dr.	$26,737.50	
	Securities	Cr.		$26,388.00
	Loss and Gain	Cr.		349.50

On its income return for the calendar year of 1936, petitioner reported the sale of the stocks as follows on page 3 of the return:

Schedule B Capital Gains and Losses (From Sales or Exchanges Only).

(See Instruction 11.)

1. Description of property	2. Date acquired	3. Date sold	4. Gross sales price (contract price)	5. Cost	9. Gain or Loss
Reed Roller Bit	10-10-29	4-28-36	.....	.....	.....
Reed Roller Bit	11-15-30	4-28-36	$13,500.00	$7,100.00	$6,400.00
Dr. Pepper	10-10-29	4-28-36	10,750.00	5,625.00	5,125.00
Columbia Gas & E.	9-18-29	4-28-36	1,725.50	11,750.00	—10,025.50
N. Amer. Aviation	3-21-29	4-28-36	762.50	1,912.50	—1,150.00
			26,737.50	26,388.00	.....

Gain or Loss (enter net amount at Item 11, page 2; if net amount is a loss, enter that amount or $2,000, whichever is less) $349.50

State (1) how property was acquired, *By purchase;* (2) whether at time of sale or exchange purchaser owned more than 50% in value of your outstanding stock, *No.*

Every sale or exchange of stock should be reported in detail, including name and address of corporation, class of stock, number of shares, capital changes affecting basis (stock dividends, other non-taxable dividends, stock rights, etc.)

Cost of property must be entered in column 5 if a loss is claimed in Column 9.

During the year of 1936, the corporation had no preferred stock outstanding. During the year 1936 the common stock of this corporation was owned and held by the following individuals:

Name	Shares owned
Louise Wintermann (mother of O. J. and E. L. Wintermann)	332
E. L. Wintermann (brother of O. J. Wintermann and son of Louise Wintermann)	332
O. J. Wintermann (brother of E. L. Wintermann, and son of Louise Wintermann)	72
David Wintermann (son of O. J. Wintermann)	130
Gloria Wintermann (daughter of O. J. Wintermann)	130
Directors (qualifying shares)	4
Total outstanding	1,000

OPINION.

BLACK:

The question which we have to decide in this proceeding may be stated thus: Where petitioner corporation, whose stock is closely held by one family, sold at one time to one of its stockholders owning directly or indirectly within the definition of section 24 (a) (6), Revenue Act of 1936, more than 50 per cent of the capital stock thereof four blocks of stock at market prices which resulted in gains as to two of the stocks and losses as to the other two, but a slight net gain on the entire tranaction, are the gains subject to tax and the losses unallowable as deduc-

tions from income under the provisions of section 24 (a) (6) of the Revenue Act of 1936? [1]

Petitioner, by an appropriate assignment of error, contests the action of the Commissioner in taxing it with the profits from the sales of the Reed Roller Bit and the Dr. Pepper stocks without allowing as an offset the losses from the sale of the Columbia Gas and the North American Aviation stocks. Petitioner relies upon the following points in support of its assignment of error:

I. That the sale made by Petitioner on April 28, 1936, was of 1,050 shares of stock sold in one transaction and for one price, $26,737.50, for stock that cost petitioner $26,388.00 resulting in a gain of $349.50 and this gain was correctly reported by Petitioner on its income tax return, there being no loss whatever in the transaction.

II. That Section 117 (d) Revenue Act of 1936 does not limit gains made on sales neither does it require taxpayers to forego more beneficial sales because of the family relationship of the purchaser.

III. That the word "loss" as used in Section 24 (a) (6) Revenue Act of 1936 is a relative term and is directly opposed to and offset by gains from the same or similar transactions.

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[1] Sec. 24. Items Not Deductible.

(a) General Rule.—In computing net income no deduction shall in any case be allowed in respect of—

* * * * *

(6) Loss from sales or exchanges of property, directly or indirectly, (A) between members of a family, or (B) except in the case of distributions in liquidation, between an individual and a corporation in which such individual owns, directly or indirectly, more than 50 per centum in value of the outstanding stock. For the purpose of this paragraph—(C) an individual shall be considered as owning the stock owned, directly or indirectly, by his family; and (D) the family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

We shall treat all three of petitioner's points together, inasmuch as they are closely related. The Commissioner, in explanation of his treatment of the transaction, states in his deficiency notice as follows:

> This office holds that the disposition of each block of stocks and bonds represents a separate sale or exchange; that the losses arising from the separate sales or exchanges are governed by the provisions of section 24 (a) (6) of the Revenue Act of 1936 and, therefore, constitute unallowable deductions, and, as such, are not to be applied to reduce the gains from the sales or exchanges of other assets.

We think the Commissioner must be sustained, on the authority of our decision in *Norman Cooledge,* 40 B. T. A. 110. In that case the taxpayer, as stockholder of a certain corporation, received an aggregate amount of cash in complete liquidation of his stock, which amount exceeded the the aggregate cost basis of his stock. The taxpayer had acquired his stock at various times and at various prices. Some of it had cost him more than the price which he received in liquidation, and some of it had cost him less. In figuring his net taxable gain on the liquidation, the taxpayer contended for the right to treat all the stock together as one block and to offset the gains on that part of his stock which he had purchased at less than he received in the liquidation by losses on that part of the stock which had cost him more than he had received in liquidation.

We held against this contention of the taxpayer, holding that under section 115 (c) of the Revenue Act of 1934 petitioner must return for taxation the entire amount of his gain on that part of his stock where he had a gain, without reference to the percentages provided in section 117 of the Revenue Act of 1934, and that his losses from

the liquidation of the stock must be limited as provided in section 117.

It is true, of course, that the sections of the statute which we had under consideration in the *Cooledge* case, *supra*, were not the same as we have in the instant case, but we think the governing principle is the same, which is that each separate piece of property must be treated separately in determining gain or loss on its sale. We think that principle holds good whether several pieces of property are sold in one transaction or in several separate transactions.

Cf. *Taylor Securities, Inc.*, 40 B. T. A. 696. In that case one of the assignments of error was that the Commissioner erred:

> * * * in not offsetting losses sustained on sales of securities in the United States against gains on similar transactions in determining the amount of petitioner's taxable income from such transactions for all the years.

In that case the taxpayer was a foreign corporation which had not filed any income tax return prior to the mailing of the Commissioner's notice of deficiency. We held that the Commissioner acted properly in taxing the taxpayer with all income from sources within the United States and in allowing no deductions, including deductions from losses from sales of stock in the United States, because of the provisions of section 233 of the Revenue Acts of 1928, 1932, and 1934. We refused the taxpayer's contention that its gains from the sale of shares of stock in the United States should be automatically offset by losses from sales of shares of stock in the United States during the same taxable years.

In *Frank C. Deering*, 40 B. T. A. 984, we did use some language which would seem to approve the contention

which the petitioner is making in the instant case. That language was as follows:

> In his determination of a capital gain in this case the respondent would treat the transactions by which the petitioner acquired the annuities in exchange for property as being a separate sale at the stipulated fair market value of the securities on December 30, 1935, of each lot of stock or bonds transferred to the wife, son, and daughter. It is only in this manner that a capital gain can be found to have resulted. We do not think that this premise is warranted. The petitioner transferred for the annuity in each case securities which cost him more than their fair market value on the date of the transfer and we do not think that the transactions may be resolved into their component parts, as has been done by the respondent in this case. * * *

The language above quoted was *dicta* in that case, and is not controlling here. The *Deering* case was decided in favor of the taxpayer, not upon the reasoning contained in the foregoing paragraph, but upon the holding that the promises for annuities were by individuals, and that these promises had no recognizable fair market value and there could be no gain or loss in such transactions.

Petitioner in its brief lays much stress on the Commissioner's instructions relating to the reporting of capital gains and losses which accompanied the income tax return which petitioner filed for 1936. The instructions quoted in petitioner's brief were as follows:

> Capital Gains and Losses. Report sales or exchanges of capital assets in Schedule B and enter the net amount of gain or loss as Item 11 (Capital losses are allowable only to the extent of $2,000 plus capital

> gains. Therefore, if the total amount of capital losses is in excess of the total amount of capital gains, the amount to be entered as Item 11 may not exceed 2,000). (See Section 117 relating to capital gains and losses.) Describe the property briefly and state the actual consideration or price received or the fair market value of the property received in exchange.

It is undoubtedly true that in the preparation of schedule B of petitioner's income tax return, the Commissioner authorized the taxpayer to offset gains from the sale of shares of stock by losses from sales of shares of stock and carry forward only the net result as item 11 of petitioner's income tax return. But it is perfectly plain that in authorizing losses to offset gains, the Commissioner means only those losses which are recognized as deductions by the statute. This is made plain by the language of the last paragraph in item 11 of the Commissioner's instructions, which the petitioner has apparently overlooked. That last paragraph reads:

> No deduction shall be allowed in respect of loss from sales or exchanges of property, directly or indirectly, except in the case of distributions in liquidation, between an individual and a corporation in which such individual owns, directly or indirectly, more than 50 per cent in value of the outstanding stock. (See section 24 (a) (6).)

The statute referred to by the Commissioner in his instructions, and which disallows petitioner the loss which it claims here, seems to be plain and unambiguous. Even though its application in the instant case may seem harsh in view of the fact that the transaction seems to have been one made for purely business reasons and not to establish a tax loss, we do not feel that we have the power

to relieve petitioner from its terms. We must give effect to laws as Congress has written them, and if any changes are to be made Congress must make them.

Reviewed by the Board.

Decision will be entered under Rule 50.

(Seal)

MOTION TO FILE TENDERED AMENDED PETITION.

27 Filed June 22, 1940.

(Title Omitted.)

Petitioner, Lakeside Irrigation Company, Inc., by its attorney, moves the Board:

1. To grant leave to petitioner to file its amended petition herewith tendered and prayed to be read in support of this motion.

2. For additional cause in support hereof, petitioner respectfully submits:

(a) The original petition recites petitioner's contract in writing duly performed before April 28, 1936, whereby petitioner delivered its certain securities at their market value, including any gain therein, as a credit and satisfaction, to the extent thereof, of its pre-existing debt to its creditor-stockholder; alleged error in the resulting proposal of gain; and prayed redetermination of its taxable income generally under the law and facts for 1936.

(b) Upon the stipulated facts the Board held the transaction was governed, although harshly, by Section

24(a)(6), and gave no recognition to other provisions of the law.

(c) Before final decision, and for rehearing purposes, the Amended Petition recites no new matters of law or fact, and only makes the original petition more definite and certain in particular aspects of the application of law, and especially Sections 14(a) (2) and 26(c), prayed generally in the original petition.

Respectfully,
LAKESIDE IRRIGATION
COMPANY, INC.,
(S.) By CAMDEN R. McATEE,
Attorney.

Denied July 5, 1940.
(Signed) EUGENE BLACK,
Member, U. S. Board of Tax
Appeals.

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29 AMENDED PETITION.

Lodged June 22, 1940.

(Title Omitted.)

Petitioner, Lakeside Irrigation Company, Inc., pursuant to leave therefor asked and granted hereby amends and amplifies its original petition for redetermination of its taxable income for the calendar year 1936 under the law and facts thereto applicable, and, for said purpose, to make said petition more definite and certain, and to conform to proof and undisputed facts, respectfully states as follows:

(C-1) The delivery of securities by petitioner to its stockholder-creditor was evidenced in writings whereby

petitioner prior to May 1, 1936, and in the year 1936, contracted and agreed to pay its certain pre-existing debt by its transfer and delivery of its securities for credit thereon at their several market values existing on the date of delivery and consummation, which was effected and concluded on April 26, 1936, and prior to May 1, 1936; and, thereby a portion of the profits of petitioner, to the extent of its gain realized in said transaction was required to be paid and was paid in said taxable year in discharge of a debt; and thereby to the extent of the amount of said profit petitioner is and was entitled to credit therefor in the computation of its 1936 calendar year tax liability, subject to the provisions of Sections 14(a)(2) and 26(c) of the Revenue Act of 1936; and, notwithstanding said sections and their application to the case of petitioner, no effect has been given them herein.

(A-1) The recognition of said profit-credit affects the proper and lawful taxation of petitioner under the Revenue Act of 1936.

Wherefore, petitioner prays for leave to file this amendment, and, as in its original petition, for cause as therein stated and here made more definite and certain, and, further, for all other proper relief.

LAKESIDE IRRIGATION COMPANY, INC.,
(S.) By CAMDEN R. McATEE,
Attorney.

District of Columbia. ss.

Camden R. McAtee, being duly sworn says he is the attorney for petitioner, and authorized to make and file this amended petition, and that the statements therein are true as he verily believes.

(S.) CAMDEN R. McATEE.

Subscribed and sworn to before me by Camden R. McAtee, this 21st day of June, 1940.

(S.) ETHEL R. GUISE,
(Seal) Notary Public, D. C.

My commission expires 12/1/42.

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32 MOTION FOR REHEARING.

Filed June 22, 1940.

(Title Omitted.)

Petitioner, Lakeside Irrigation Company, Inc., by its attorney, moves the Board:

1. For a rehearing and for said purposes:

(a) To set aside and vacate its opinion and conclusions of law upon the stipulated case of fact herein made and found.

2. In support of said motion, petitioner respectfully states:

(a) The Board erred in not deriving from the petition and stipulated facts the entire statutory rights of petitioner.

(b) The Board erred in not sustaining the computation of gain from the transfer of the securities, computed and exhibited in its return by petitioner, and recited in the Board opinion.

(c) The Board erred in holding the petitioner liquidation of its debt to its stockholder-creditor was a sale or

exchange of property, and, as such, was allowable into particular items.

(d) The Board erred in its construction of Section 24(a)(6) of the Revenue Act of 1936, and, particularly in drawing into same other Sections of the Revenue Acts applicable to the state of facts disclosed in its cited Coolidge and other decisions, but not existing herein.

(e) The Board erred in its construction of said Section 24(a) (6) as literally applicable to the case of petitioner.

(f) The Board erred in not giving effect to Section 26(c) of the Revenue Act of 1936, in determining the taxable income status of petitioner.

(g) The Board erred in other respects apparent of record.

(h) A rehearing and further consideration of the case are necessary to do justice to petitioner.

Respectfully,
LAKESIDE IRRIGATION COMPANY, INC.,
(S.) By CAMDEN R. McATEE,
Attorney.

ORDER DENYING MOTION FOR REHEARING.

34 (Title Omitted.)

On June 22, 1940, petitioner filed a Motion for Rehearing which has been duly considered according to the Board's Rules of Practice. For reasons stated in the memorandum which accompanies this order, it is believed that said motion should be denied. Accordingly, it is

Ordered and Decided, that petitioner's Motion for Rehearing should be, and it is, hereby denied.

(S.) EUGENE BLACK, Member.

Dated—Washington, D. C., July 3, 1940.

MEMORANDUM TO ACCOMPANY ORDER DENYING MOTION FOR REHEARING.

35 (Title Omitted.)

BLACK:

On April 23, 1940, Findings of Fact and Opinion were promulgated in this proceeding. On June 22, 1940, petitioner filed Motion for Rehearing. All the grounds urged in said motion have been carefully considered but it is believed that only two of them require separate discussion. These two are:

> (c) The Board erred in holding the petitioner liquidation of its debt to its stockholder-creditor was a sale or exchange of property, and, as such, was allocable into particular items.
>
> (f) The Board erred in not giving effect to Section 26(c) of the Revenue Act of 1936, in determining the taxable income status of petitioner.

These two grounds will be considered separately.

The effect of petitioner's ground (c), quoted above, is to contend that the Board erred in applying section 24 (a)(6) of the Revenue Act of 1936 for the reason that petitioner did not make either a "sale" or "exchange" when it transferred the stocks of the four corporations to petitioner's stockholder Louise Wintermann in considera-

tion for the cancellation by Louise Wintermann of indebtedness in the amount of $26,737.50, which amount was the fair market value of the stocks transferred to her.

We think petitioner's contention in this respect is without merit for two reasons: (1) the existing record in this case shows as a fact that the transfers in question were sales and (2) the decisions in several cases hereinafter mentioned clearly hold that transactions of this kind are as a matter of law regarded as sales.

(1) In paragraph Third (1)(d) of its petition petitioner alleges in part "that it sold all its stock in one sale, made a profit on one sale, and though it bought the stocks at four different times, it did not have a profit or loss on its purchases but only on the one sale." Paragraph 6 of the stipulation of facts filed at the hearing is as follows:

> 6. Immediately following the directors' meeting on April 20, 1936, steps were taken by the corporation to ascertain the market values of the respective stocks being sold to Mrs. Wintermann. On April 28, 1936, the inquiries were completed, the stocks were delivered to Mrs. Wintermann, and the indebtedness of the corporation to her was reduced by the sum of $26,737.50, representing the aggregate market value of the four stocks on the date of the sale. The following tabulation shows the date of acquisition and the cost and selling price of each of the four stocks sold, as well as the resulting gain or loss with respect to the separate stocks and the resulting net gain to petitioner on the sale of the four stocks treated as a unit.

(2) Moreover, aside from the admissions in the pleadings and the stipulation of facts that the transactions were sales or exchanges, we think that under the adjudicated

cases the transfers in the instant case must be regarded as "sales" or "exchanges" from which it would follow that the Board's report is correct and that petitioner's motion for rehearing should be denied.

In *Rogers v. Commissioner*, 103 Fed. (2d) 790, 22 A. F. T. R. 1129, certiorari denied October 9, 1939, the taxpayer and his wife, as part of the purchase price of income-producing property, gave a note secured by a trust deed, and later, in 1933, they transferred the property to the note holder in consideration for the cancellation of the note. The Court in affirming the Board, 37 B. T. A. 897, held that the transfer of the property constituted a "sale" of a capital asset. Excerpts from this opinion are as follows:

> The principal contention presented is that the transaction was not a 'sale or exchange' under the Act. The petitioners assert that they received nothing from the transaction and that a 'sale' imports both parties to the transaction receive something. Moreover, they cite cases to the effect that payment of an obligation according to its terms is not a sale or exchange. But, obviously, here was no payment of an obligation according to its fixed terms.
>
> [2] As defined by *Iowa v. McFarland*, 110 U. S. 471, 478, 4 S. Ct. 210, 214, 28 L. Ed. 198, 'A sale, in the ordinary sense of the word, is a transfer of property for a fixed price in money or its equivalent.' See, also, *United States v. Benedict*, 2 Cir., 280 F. 76, 80; *Gallus v. Elmer*, 193 Mass. 106, 78 N. E. 772, 8 Ann. Cas. 1067.
>
> [3] The Supreme Court of the State of California has answered the contention that the transaction could not be a 'sale' because the petitioners received nothing

therefrom—'It is well settled in this state that the extinguishment of security or a pre-existing debt constitutes a valuable consideration for the sale or assignment of property.' *Ferguson v. Larson*, 139 Cal. App. 133, 135, 136, 33 F. 2d 1061, 1062.

* * * *

In any event, we are of opinion that here, a 'sale' of a capital asset was accomplished and that the deduction must be taken under the capital asset section.

See also *Pender v. Commissioner*, 110 Fed. (2d) 477, certiorari denied June 3, 1940; *Wieboldt v. Commissioner*, paragraph 9525, 1940 CCH, decided June 13, 1940.

We will next discuss petitioner's ground (f) for rehearing, quoted above.

That part of section 26(c) which petitioner would rely upon if its motion was granted is doubtless as follows:

Sec. 26. Credits of Corporations:

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * *

(c) Contracts Restricting Payment of Dividends.—

* * * *

(2) Disposition of Profits of Taxable Year.—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the cor-

> poration prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word 'debt' does not include a debt incurred after April 30, 1936.

We do not think petitioner's contention (f) presents good grounds as to why we should grant a rehearing in this case, for the following reasons:

(1) In the first place this would be raising a new issue not heretofore raised or passed upon by the Board. In paragraph 9 of the stipulation filed with the Board "It is further agreed that in the event the Board approves the action of the Commissioner as to the issue presented for decision, then the correct deficiency is as set forth in the deficiency notice, a true copy of which is attached to the petition." The Board in its report reviewed by the full Board did approve the action of the Commissioner.

The petitioner made only one assignment of error and that is stated in the petition as follows:

> (1) The Commissioner of Internal Revenue erred in his adjustment (a) wherein he sets up an additional income arising from Capital Gains of $11,175.50. From this source and by this error overstates Petitioner's income by Eleven Thousand One Hundred Seventy-five and 50/100 ($11,175.50) Dollars.

Thus it will be seen that nowhere in the petition did petitioner allege that the Commissioner had erred in failing or refusing to allow petitioner a proper credit under any of the provisions of section 26(c) of the Revenue Act of 1936.

Now after the case has been tried and the Board's opinion has been promulgated deciding the issues presented by the pleadings and the briefs, it is not believed that the Board should grant petitioner a rehearing to allow it to raise an entirely new issue. Cf. *O'Rear v. Commissioner*, 80 Fed. (2d) 473, and cases there cited.

(2) But even if the Board should permit petitioner to amend its petition and raise this new issue, it would seem that section 26(c)(2), *supra*, would not be applicable for the following reasons: There was no "written" contract executed by petitioner prior to May 1, 1936. The stipulation in this respect shows that petitioner's president wrote to Louise Wintermann on April 16, 1936, in part as follows:

> Now we can either sell this stock outright or we can turn it over to you to apply on the obligation due from the Irrigation Company, and you will get a credit of approximately $25,000.00. Of course, if we turn it over to you, if the Company ever got in dire need, you can let us use it as collateral security in case it is not to be sold.

The stipulation then continues as follows:

> On April 19, 1936, Mrs. Louise Wintermann accepted the offer to sell and advised that she preferred to buy the stock at market price. This acceptance was by long-distance telephone direct to O. J. Wintermann.

The foregoing facts evidence a written offer of sale of property and an oral acceptance thereof. This would not seem to fulfill the requirement of section 26(c)(2), which reads in part "An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, * * * to the extent that such amount has been so paid or set aside. * * *

Because of the foregoing reasons, it is believed that petitioner's motion for a rehearing should be denied. An order denying said motion will be entered in accordance herewith.

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40 DECISION.

United States Board of Tax Appeals.

Lakeside Irrigation Company, Inc., Petitioner,
vs. Docket No. 96745.
Commissioner of Internal Revenue, Respondent.

The Board promulgated its opinion in this proceeding April 23, 1940, and respondent has filed Computation for Entry of Decision in pursuance of Rule 50 of the Board's Rules of Practice. Same came on for hearing July 24, 1940, and petitioner did not contest the correctness thereof. Respondent's computation has been examined and it appears to be in accordance with the Board's opinion promulgated April 23, 1940. Accordingly, it is

Ordered and Decided, that there is a deficiency in petitioner's income tax liability for the year 1936 of $3,556.22.

(Signed) EUGENE BLACK,
(Seal) Member.

Enter: Entered July 25, 1940.

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41 MOTION.

Filed Sept. 20, 1940.

(Title Omitted.)

Petitioner, Lakeside Irrigation Co., Inc., by its undersigned attorney moves the Board:

(1) To rehear petitioner upon its motions for rehearing and for leave to file amended petition heretofore overruled *ex parte*, and

(2) For the purposes thereof, to set aside its order of redetermination of deficiency entered herein on July 25, 1940, and whereon the time for petition for review will expire on September 25, 1940.

For cause, the undersigned respectfully shows:

(a) The original petition, by Texas counsel, prayed redetermination generally, upon the facts and applicable law, of a proposed deficiency determination of $3,556.22 for 1936, alleging as error the overstatement of net income in the amount of $11,175.50, based upon the delivery by a family corporation on April 28, 1936, of certain portfolio stocks, at their market value, as a pro tanto

payment and credit upon a corporate debt previously owing to said stockholder.

(b) Upon hearing the facts were undisputed and further showed said transaction was the consummation of a written corporate resolution adopted before May 1, 1936. In its opinion, the Board in upholding the proposed redetermination expressed regret at the harshness of the statutory rule applied to the case of petitioner.

(c) The motion for rehearing in relation to the tendered amended petition sought and seeks the application of said capital gain as a credit pursuant to Section 26(c)(2) of the Revenue Act of 1936 for purposes of the ensuing Rule 50 recomputation.

(d) Notice of denial *ex parte* thereof, notice of the date for redetermination and notice of the redetermination of deficiency were all sent to Texas and undersigned had no notice of said proceedings until he received copy of the redetermination order some time after its entry.

(e) In the *ex parte* denial, the Board was without benefit of brief and failed to pass on the corporate resolution as bringing the recomputation under Section 26(c)(2) for application thereof.

(f) This motion is not filed for mere delay.

LAKESIDE IRRIGATION COMPANY, INC.,
(S.) By CAMDEN R. McATEE,
Attorney.

44 ORDER.

(Title Omitted.)

Upon motions of petitioners therefor filed and hereby granted, it is therefore

Ordered that the deficiency determination against petitioner in the amount of $3,556.22 entered herein on July 25, 1940, be and same is set aside without prejudice, and

That petitioner be reheard upon its motions to set aside or modify the opinion herein and file its amended petition, and that such rehearing on petitioner's said motion be set for Wednesday, October 16, 1940, in Washington, D. C.

(S.) EUGENE BLACK,
(Seal) Member.

Dated at Washington, D. C., September 20, 1940.

ORDER DENYING MOTION FOR REHEARING.

45 (Title Omitted.)

On June 22, 1940, petitioner filed a Motion for Rehearing which has been duly considered according to the Board's Rules of Practice. For reasons stated in the memorandum which accompanies this order, it is believed that said motion should be denied. Accordingly, it is

Ordered and Decided, that petitioner's Motion for Rehearing should be, and it is, hereby denied.

(Signed) EUGENE BLACK, Member.

Dated—Washington, D. C., January 10, 1941.

MEMORANDUM TO ACCOMPANY ORDER DENYING PETITIONER'S MOTION FOR REHEARING.

46 (Title Omitted.)

BLACK:

On April 23, 1940, findings of fact and opinion were promulgated in this proceeding and at the conclusion of our opinion we directed that "Decision will be entered under Rule 50."

On June 22, 1940, petitioner filed motion for rehearing. This motion was denied July 3, 1940, and on July 25, 1940, the Board entered its decision in this proceeding.

The petitioner, on September 20, 1940, filed a motion asking the Board to vacate its decision of July 25, 1940, and to hear petitioner in argument in support of its motion for rehearing filed on June 22, 1940. Whereupon the Board vacated its decision of July 25, 1940, without prejudice, and agreed to hear argument on petitioner's motion for rehearing. Argument on said motion was heard October 30, 1940, and has been fully considered. It is not believed, for reasons hereinafter stated, that petitioner's motion for rehearing should be granted.

Petitioner, in argument, presents two grounds as to why its motion for rehearing should be granted. These grounds may be briefly stated as follows: (1) The Board erred in holding that section 24(a)(6), Revenue Act of 1936, is applicable to a state of facts such as we have in the instant case. (2) Petitioner should be allowed to amend its petition and ask for a credit of $11,525 under the provisions of section 26(c)(2), Revenue Act of 1936, in a computation of its undistributed profits surtax; or if the Board should disallow such an amendment to the petition it should nevertheless allow such a credit in a computation of the deficiency under Rule 50.

Petitioner, at the hearing of his motion for rehearing, filed with the Board "Petitioner's Computation for Entry of Decision" in which the credit for the $11,525, aforesaid, was taken. Petitioner's computation thus made showed a deficiency of $1,426.63 instead of $3,556.22, the amount of the deficiency arrived at without the credit of $11,525, which petitioner claims.

We shall take up and discuss briefly the two grounds urged in oral argument which we have stated above. As to petitioner's ground (1), petitioner presents no new argument from that which the Board has already considered in arriving at its opinion heretofore promulgated. In that opinion we pointed out that section 24(a)(6), Revenue Act of 1936, seemed to be plain and unambiguous, and said "Even though its application in the instant case may seem harsh in view of the fact that the transaction seems to have been one made for purely business reasons and not to establish a tax loss, we do not feel that we have the power to relieve petitioner from its terms." To that view we must still adhere. We do not think that the statute in question is susceptible to any other construction than that which we have given it.

As to petitioner's ground (2), it asks leave to amend its petition so as to claim credit under section 26(c)(2), Revenue Act of 1936, for $11,525 in computing its undistributed profits surtax. Petitioner also contends that even though the Board should not allow such an amendment to the petition, that nevertheless the facts which are in evidence show that petitioner is entitled to such a credit, and therefore such a credit should be allowed in a computation under Rule 50 of the Board's Rules of Practice. The Board in passing upon this part of petitioner's motion for rehearing does not wish to stand upon any rule of technicality. The facts are all in evidence and the proceeding is still before the Board. Therefore, if the Board

thought the position of petitioner was well taken we would not hesitate to grant petitioner's motion for rehearing and allow it to amend its petition in the manner asked for and then grant petitioner the relief asked. However, we do not think that petitioner's position is well taken. Section 26(c)(2), under which petitioner claims the right to take the credit of $11,525, reads as follows:

> (c) Contracts Restricting Payment of Dividends.—
>
> * * * *
>
> (2) Disposition of Profits of Taxable Year.—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

In *G. B. R. Oil Corporation*, 40 B. T. A. 738, we said:

> In determining whether the claimed credit of a corporate taxpayer falls within section 26(c)(2) and the regulations promulgated thereunder, three things seem to be necessary:

(1) There must be a written contract executed prior to May 1, 1936, which expressly deals with the disposition of earnings and profits of the taxable year.

(2) The credit relates to that portion of the earnings or profits which are required to be paid or irrevocably set aside in the discharge of a debt.

(3) The credit is allowable to the extent that the money has been so paid or set aside.

It of course goes without saying that if (1), named above, is absent from a given case, then the taxpayer is not entitled to a credit under section 26(c)(2). Petitioner does not contend to the contrary, but contends that petitioner had entered into such a written contract prior to May 1, 1936, and that such written contract consisted of certain resolutions of petitioner's board of directors adopted on April 20, 1936, and which resolutions were carried out. With reference to such resolutions and the action taken thereunder, the stipulation shows as follows:

On April 20, 1936, a called meeting of directors was held and page 79 of the Minute Book shows as follows:

"Minutes of the Directors' Meeting April 20, 1936 (at 2 o'clock P. M. at the office of the Company) There were present at the meeting the following directors:

O. J. Wintermann, David Wintermann and G. L. Butler.

* * * *

At the Directors' Meeting on February 25, 1936, it was recommended that the investment stocks held

by the company be sold; the president stated that he had been advised by Louise Wintermann that she would take the stocks held by the company at their market value to be applied on the company's indebtedness to her; whereupon the following resolution was offered:

'Resolved that the president be directed to ascertain immediately the market value of all the investment stocks held by the company and, when this is done, that he deliver these stocks to Louise Wintermann as soon as he has satisfied himself as to their market value, it being the intention of the Board that all these stocks be delivered at one time and as of the market value on a certain date, and that the company credit the market value of these stocks as of the value date in a lump sum to the account of Louise Wintermann.'

A motion for the resolution was made, duly seconded and unanimously passed.

There being no further business, the meeting was adjourned.

Approved:
O. J. WINTERMANN,
President.

Attest:
G. L. BUTLER."

6. Immediately following the directors' meeting on April 20, 1936, steps were taken by the corporation to ascertain the market values of the respective stocks being sold to Mrs. Wintermann. On April 28, 1936, the inquiries were completed, the stocks were de-

> livered to Mrs. Wintermann, and the indebtedness of the corporation to her was reduced by the sum of $26,737.50, representing the aggregate market value of the four stocks on the date of the sale. * * *

We do not think the foregoing corporate resolution constitutes the sort of a written contract required by section 26(c)(2) of the Revenue Act of 1936.

Recently the Board in a memorandum opinion entered December 3, 1940, in the proceeding of *Pittsburgh Cut Flower Company* held that a corporate resolution to pay out of current earnings amounts with interest due under two notes securing advances made to the corporation, does not constitute a written contract executed by the corporation restricting payment of dividends within the intendment of section 26(c)(2), Revenue Act of 1936. In that memorandum opinion, after quoting from the Supreme Court's recent decision in *Helvering v. Northwest Steel Rolling Mills, Inc.*, ... U. S. ..., we said:

> * * * In *Davison-Joseph Campau Realty Co.*, 41 B. T. A. 675, we held that a corporate by-law did not constitute a contract so as to confer credit under section 26(c)(1) of the Revenue Act of 1936. Under the language of the Supreme Court we think no distinction can be made, on the question here at hand, between by-law, charter or corporate resolution. In our opinion there is not shown herein a "written contract executed by the corporation" within the intendment of section 26(c)(2) of the Revenue Act of 1936. We therefore conclude and hold that the respondent did not err in denying the credit claimed.

We do not think that the corporate resolution of April 20, 1936, together with the action taken thereon would entitle petitioner to a credit under section 26(c)(2). Cf.

Nocona Cotton Seed Oil Co., 42 B. T. A. ..., promulgated November 8, 1940.

Therefore for the reasons above stated, an order will be entered denying petitioner's motion for rehearing and the Board's decision of July 25, 1940, which was later vacated, will be reentered.

Entered Jan. 10, 1941.

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50 DECISION.

United States Board of Tax Appeals.

Lakeside Irrigation Company, Inc., Petitioner,
vs. Docket No. 96745.
Commissioner of Internal Revenue, Respondent.

The Board promulgated its opinion in this proceeding April 23, 1940, and respondent has filed computation for entry of decision in pursuance of Rule 50 of the Board's Rules of Practice. On July 25, 1940, the Board entered its decision in accordance with the computation filed by respondent. Subsequently this decision was vacated without prejudice to permit consideration of a motion for rehearing which had been filed by the petitioner. Said motion for rehearing has now been fully considered and denied. Accordingly, it is

Ordered and Decided that there is a deficiency in petitioner's income tax liability for the year 1936 of $3,556.22.

(Signed) EUGENE BLACK, Member.

Enter: Entered Jan. 10, 1941.

PETITION FOR REVIEW WITH ASSIGNMENT OF ERRORS.

(U. S. B. T. A. Tax Determination.)

51 Filed Feb. 13, 1941.

(Title Omitted.)

To the Honorable Judges of the United States Circuit Court of Appeals for the Fifth Circuit:

Petitioner, Lakeside Irrigation Co., Inc., being aggrieved hereby, petitions for review of the decision of the United States Board of Tax Appeals of January 10, 1941, that petitioner as a deficiency liability for income and excess profits taxes in the amount of $3,556.22 for the calendar year 1936, as duly entered in the proceeding before said Board entitled as above under Docket No. 96745, and for cause respectfully shows:

I.

Petitioner is a corporation organized under the laws of Texas. Its principal office at Eagle Lake, Texas, and the office of the Collector of Internal Revenue, where its 1936 federal tax return was duly filed, are within the Circuit of this Court; the respondent is the official appointed and qualified Commissioner of Internal Revenue; this petition for review is filed within three months after entry of the final decision of the Board as aforesaid; whereby petitioner claims this Court has jurisdiction hereof, pursuant to Sections 1001-2 of the Revenue Act of 1936 as amended.

II.

In April, 1936, Mrs. Louise Winterman was a creditor of petitioner in the sum of $30,000 more or less, long over-

due as rent of her properties used by petitioner, and was the owner directly, and indirectly by reason of ownership of her children and grandchildren, of more than 50% of the capital stock of petitioner. Petitioner, the owner of stocks in four corporations, decided to use same substantially to pay off its debt to Mrs. Winterman. For petitioner, its president offered her the net proceeds from petitioner-sale of its stocks, or, alternatively, the stocks themselves at their current market value with the provision that she would let petitioner use them as collateral security in case of its subsequent dire need. She accepted the alternative offer, and petitioner thereupon by resolution authorized its president to deliver to her all the stocks at one time at their then ascertained market value, and to credit her account with one lump sum. The stocks were delivered and the credit to her account was made on April 26, 1936, in the amount of $26,737.50 their aggregate market price, which was shown upon petitioner books as a total cost of $26,388.00, and a net gain from the transaction of $349.50. The net gain was computed by comparison of the market value at its delivery with the original cost of each stock; therefrom, a total gain of $11,525.00 on two of the stocks offset by a total loss of $11,175.50 on the other two stocks, established the net gain from the transaction of $349.50, which petitioner subsequently computed again and reported in its 1936 tax return as a compliance with Section 117(d) and with the directions and instructions of respondent to taxpayers for making the return.

Upon review of the return, respondent separated the single transaction into four transfers or sales, held the offset of the loss of $11,175.50 against the gain of $11,525.00 was forbidden by Section 24(a)(6) of the Revenue Act of 1936, thereby increased net income in the amount of $11,175.50 and proposed a deficiency thereon. Petitioner petitioned the Board of Tax Appeals for redeter-

mination under the law and facts, also alleging said increase as particular error, and the Board affirmed, while holding but one transaction was intended, that it was a purely business transaction, and that application of Section 24(a)(6) was admittedly harsh in the circumstances. Petitioner thereupon moved the Board for a rehearing and for leave to file tendered amended petition making definite upon the facts found the right of petitioner to use the gain from the transaction as a credit under Section 26 (c)(2) of the Revenue Act of 1936 in computing its surtax on undistributed profits. The Board denied the motion on the ground the corporate resolution was not a written contract within the meaning of said section, and entered the deficiency originally proposed as its decision.

III.

The questions presented herein are:

Where petitioner, before May 1, 1936, in one transaction pursuant to a corporate resolution, transferred to one of its stockholders owning directly or indirectly within the definition of Section 24(a)(6), Revenue Act of 1936 more than 50% of the capital stock of petitioner four blocks of stock of other corporations at their market values in satisfaction to the extent of the market values of a preexisting overdue debt of petitioner to said stockholder, and where said transfer showed a gain by petitioner as to two of the stocks and losses as to the other two, with but a slight net gain on the entire transaction:

To what extent may respondent break down an admitted single transaction into separate transactions to determine gain or loss.

To what extent are the taxation of the gains and the allowance or disallowance of the losses as deductions from

income governed by Sections 117(d) by 24(a)(6) of the Revenue Act of 1936, and by the directions and instructions to taxpayers for preparation of the 1936 return.

To what extent is the gain from the transaction a credit, under Section 26(c)(2) of said Revenue Act, in computing the surtax on undistributed profits as a disposition of profits of the taxable year applied in discharge of a debt pursuant to the corporate resolution as a written corporate contract executed before May 1, 1936.

IV.

Believing there is manifest error in the opinions and determinations of the Board, petitioner makes the following:

Assignment of Errors.

The Board erred:

I(a) In holding the single transaction found in fact to be nevertheless severable into parts for determination of loss and gain, and in so denying its existence in fact.

(b) In holding the transaction to be within and entirely governed by Section 24(a)(6) of the Revenue Act of 1936 for purposes of determining gain or loss therefrom, and in so refusing to give effect to Section 117(d) thereof and to the directions and instructions to taxpayers as to the contents of the return.

(c) In holding petitioner not to be entitled to credit under Section 26(c)(2) of the Revenue Act of 1936, of any gain from the transaction for purposes of computing the surtax on undistributed profits.

(d) In holding petitioner not to be entitled to file its amended petition nor to the relief therein prayed.

II. In other respects apparent of record.

Wherefore, petitioner respectfully prays that this Honorable Court require transmission of delivery by the Clerk of said Board of Tax Appeals of certified copies of all papers and documents necessary to presentation of this petition, and, upon review and hearing, that the decision of the Board be reversed and set aside, and for all other proper relief.

LAKESIDE IRRIGATION CO., INC.,
(S.) By CAMDEN R. McATEE,
Attorney.

District of Columbia. ss.

Camden R. McAtee, being duly sworn says he is attorney for the petitioner herein; that he knows the contents of the foregoing petition, and to the best of his knowledge and belief the statements therein are true, and the assignments of error are well taken and intended to be argued.

(S.) CAMDEN R. McATEE.

Subscribed and sworn to before me by Camden R. McAtee, this 12th day of February, 1941.

(S.) ETHEL R. GUISE,
(Seal) Notary Public, D. C.

NOTICE OF FILING PETITION FOR REVIEW

58 Filed Feb. 13, 1941.

(Title Omitted.)

Hon. J. P. Wenchel, Chief Counsel,
Bureau of Internal Revenue,
Washington, D. C.

Please take notice that on February 13th, 1941, a petition for review by the United States Circuit Court of Appeals for the Fifth Circuit of a decision of the Board heretofore rendered on this proceeding was filed on and in behalf of the petitioner with the Clerk of said Board, Washington, D. C., and a true copy of said petition, including assignments of error, is herewith served upon you.

(S.) CAMDEN R. McATEE,
Attorney for Petitioner.

Service of above notice and receipt of copy of Petition for Review is hereby acknowledged this 13th day of February, 1941.

J. P. WENCHEL, W.
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

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59 AGREED PRAECIPE.

Received Mar. 7, 1941.

Filed Mar. 7, 1941.

(Title Omitted.)

The Clerk will please prepare the record herein *sur* petition for review of the above proceeding before the

United States Circuit Court of Appeals for the Fifth Circuit by inclusion of the following:

1. Docket entries.

2. Petition and 60 day letter.

3. Answer.

4. Stipulation of facts, excluding Exhibit A for the reason that the material portion thereof are quoted in the concluding paragraphs of the opinion of the Board. Camden R. McAtee, J. P. Wenchel, W. 4-2-41.

5. Finding of Facts and Opinion.

6. Petitioner Motion for leave to file amended petition.

7. Amended petition tendered.

8. Motion to set aside and vacate decision of July 25, 1940.

9. Decision.

10. Petitioner Motion for rehearing and leave.

11. Order setting aside decision and granting rehearing.

12. Order denying.

13. Memo. opinion thereon.

14. Decision.

15. Petition for review with service notation.

16. This praecipe.

17. Orders extending time, if any.

(S.) CAMDEN R. McATEE,
Attorney for Petitioner.
J. P. WENCHEL,
Attorney for Respondent

W

Dated this 7th day of March, 1941.

61 CERTIFICATE.

United States Board of Tax Appeals,
Washington.

Lakeside Irrigation Company, Inc., Petitioner,
vs. Docket No. 96745
Commissioner of Internal Revenue, Respondent.

I, B. D. GAMBLE, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 60, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In Testimony Whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 5th day of April, 1941.

B. D. GAMBLE,
(Seal) Clerk, United States Board of Tax Appeals.

[fol. 65] That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

ARGUMENT AND SUBMISSION

Extract from the Minutes of March 4, 1942

No. 9897

LAKESIDE IRRIGATION COMPANY, INC.

versus

COMMISSIONER OF INTERNAL REVENUE

On this day this cause was called, and, after argument by Camden R. McAtee, Esq., for petitioner, and Edward H. Hammond, Esq., Special Assistant to the Attorney General, for respondent, was submitted to the Court.

[fol. 66] OPINION OF THE COURT—Filed May 20, 1942

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 9897

LAKESIDE IRRIGATION COMPANY, INC., Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition for Review of Decision of the United States Board of Tax Appeals (District of Texas)

(May 20, 1942)

Before Foster, Sibley and McCord, Circuit Judges

SIBLEY, Circuit Judge:

The taxpayer corporation in the tax year 1936 was indebted to a stockholder in a large amount long past due. Its president by letter advised her that the corporation

wished to sell four named lots of stock it owned in other unrelated corporations and apply the proceeds in part payment of her debt, or if she preferred would transfer the stocks to her for a credit of their market value. By telephone she elected to take the stocks. The directors by [fol. 67] a formal resolution on their minutes directed the president to ascertain the market values, and deliver the stocks at one time for a credit in a lump sum of their aggregate market value. This was done. On two lots of the stock there were gains over their cost of $11,525. On the other two there were losses aggregating $11,175.50. The taxpayer on its income tax return returned only the net gain of $349.50. The Board of Tax Appeals, sustaining the Commissioner, held that the gains of $11,525 must be returned, and that the losses of $11,175.50 could not be deducted, since this stockholder and her children and grandchildren owned more than 50 percentum of the taxpayer's outstanding stock, because of Revenue Act of 1936, Sect. 24(a)(6). The taxpayer then asked a credit of this gain against the basis of its undistributed profits tax, under Sect. 26(c)(2). This credit was denied because the resolution of the directors was not the sort of written contract meant by this section.

The taxpayer first urges here that the transfer of the stocks for a credit on a corporate debt was neither a sale nor exchange of them, but some other disposal, and therefore not a transaction within Section 24(a)(6). The section declares: "In computing net income, no deduction shall in any case be allowed in respect of * * * (6) loss from *sales or exchanges* of property, directly or indirectly * * * (B) * * * between an individual and a corporation in which such individual owns, directly or indirectly, more than fifty percentum in value of the outstanding stock." Indirect ownership is defined to include ownership by lineal descendants. The phrase "sale or exchange" occurs frequently in the Revenue Acts. We considered its meaning quite recently as used in Section 117(d) of the Revenue Act of 1934, and held that a voluntary transfer of property in payment of a debt personally owed was either a sale or an exchange. *Burger-Phillips Co. vs. Commissioner,* — Fed. (2) —. The same reasoning will apply to a transfer of property for a credit on such a debt. We think the [fol. 68] words sale or exchange in both Sections have the

same meaning, and in this case there were sales or exchanges within Sect. 24(a)(6).

On the question whether for tax purposes what happened is one single and inseparable sale or exchange, or may and must be considered as four, no direct authority is cited. We are of opinion that in ascertaining gain and loss by sales or exchanges of property previously purchased, in general each purchase is a separate unit as to which cost and sale price are to be compared. If less than all of a purchase is sold, either a credit on the cost of all is to be entered, or a proportion of the cost is to be attributed to what is sold, as Regulations may have prescribed. If several things separately bought are welded into some physical or business unit, as where bricks, lumber and hardware are made into a house, or machines and buildings are made into a plant, and then sold together, the cost is the aggregate costs of the ingredients, and the sale price is that of the whole, for separation would be impracticable and unreasonable. But where, as here, four unrelated lots of stock were separately acquired and might readily have been separately sold, the fact that after ascertaining the value of each lot all were transferred together for a lump price will not require or authorize a merger of costs. The United States may enquire as to which stocks were disposed of at a profit and tax the profit, and may ignore losses altogether on the disposal of other stocks, though realized at the same time and in the same transaction. Section 24(a) is emphatic in declaring that in the transactions it names, including loss from sales or exchanges between persons related as they are here, "no deduction shall in any case be allowed". It seems hard that this is so in this case, because it would have been otherwise had the stocks been sold and the money paid to the creditor stockholder, who might with the money have bought these or like stocks; but thus the statute is written. [fol. 69] Lastly, the additional gain thus charged to the taxpayer went to increase the basis of its tax on undistributed profits. The claim is made that the directors' resolution, dated prior to May 1, 1936, which directed the disposal of the stocks for a credit of their value on the corporation's debt, was a written contract executed by the Corporation which required this part of the "earnings and profits of the taxable year" to be paid on a debt, so as to entitle to

a credit under Sect. 26(c)(2). Assuming that there was a written contract executed by the Corporation, without so deciding, we think it wholly fails to satisfy the statute, which demands a "provision of a written contract * * *, which provision *expressly* deals with the disposition of the earnings and profits of the taxable year." This resolution makes no mention at all of earnings and profits. It so happens that a gain was realized by applying the stocks to a debt as the resolution required, but the resolution did not require anything to be done with the gain so produced. Moreover, the phrase "earnings and profits of the taxable year" refers to them as ascertained for the whole or a part of the year, and not to some single item of gain in a particular transaction.

The judgment of the Board of Tax Appeals is Affirmed.

[fol. 70] JUDGMENT

Extract from the Minutes of May 20, 1942

No. 9897

LAKESIDE IRRIGATION COMPANY, INC.

versus

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of Lakeside Irrigation Company, Inc., for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the judgment of the said United States Board of Tax Appeals in this cause be, and the same is hereby, affirmed.

[fol. 71] Clerk's Certificate to foregoing transcript omitted in printing.